

Balance Sheet Data:	1999	2000	2001	2002	2003
Cash, cash equivalents, short-term investments and restricted cash\$	1,535	\$112,429	\$75,934	\$56,196	\$36,835
Working capital	1,897	128,332	70,873	58,612	50,218
Total assets	5,864	146,212	83,004	64,210	81,732
Long-term debt, less current portion	158	90	9	--	--
Redeemable convertible preferred stock	12,467	--	--	--	--
Total stockholders' equity (deficit)	(9,897)	135,476	74,489	60,876	64,224

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We develop, manufacture and distribute server appliance solutions that enable network equipment providers and independent software vendors, or ISVs, to deliver data storage and security networking applications to their customers. Server appliances are pre-configured network infrastructure devices designed to deliver specific application functionality. The server appliance is sold and supported either by the network equipment or ISV partner or alternatively by us through our Distribution operation. We also distribute third party data storage networking connectivity products to our customer base of over 400 value-added resellers, or VARs, and systems integrators.

On December 27, 2002, we acquired TidalWire Inc., a value-added distributor specializing in the distribution of data storage networking connectivity products, primarily Fibre Channel host bus adapters, or HBAs. In addition to the revenue associated with our TidalWire Distribution business, the acquisition provided us with a sophisticated logistics system, relationships with over 400 VARs and systems integrators and expanded post-sales support capabilities. The acquisition of TidalWire enables us to offer these distribution capabilities to current and future ISV partners and thereby gives us the ability to expand our server appliance business.

At the time of our initial public offering in July 2000, we were developing custom server hardware platforms for internet-based organizations, content infrastructure providers and larger enterprises. In response to competitive pressures and a significant downturn in the economy that negatively affected our customers, we implemented two restructurings of our operations during fiscal 2001. In the April 2001 restructuring, we sought to better align our operating expenses with reduced revenues. In the July 2001 restructuring, we refocused our sales strategy toward strategic partnerships with network equipment providers and ISVs and discontinued much of the customized hardware and software that was previously included in our server appliance solutions. Today, we combine our hardware packaging, system design and software integration expertise with our manufacturing, distribution, logistics and post-sales support capabilities to provide a complete solution for our application provider customers.

We are currently organized into two reportable segments: OEM Appliance and Distribution.

OEM Appliance operations

Our OEM Appliance operation leverages our server appliance development, manufacturing and logistics services. We produce and fulfill devices branded for our network equipment and ISV partners, and we derive our revenues from the sale of the value-added hardware platform to these partners. These partners subsequently sell and support the device under their own brands to their customer base.

Distribution operations

Revenues from our Distribution operations are derived from two activities; first is the revenue derived from the distribution of third party products and components, primarily related to data storage area networking; second is the distribution of server appliances that we develop, manufacture, sell and support on behalf of our ISV partners.

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Complementary product and component Distribution revenues. Substantially all of our Distribution operations' revenue is currently derived from the distribution of third party data storage components and products, predominantly EMC-approved Fibre Channel HBAs. We are one of two authorized distributors in North America for Fibre Channel HBAs that have been tested and approved by EMC. We are also a distributor of standard Fibre Channel HBAs, network switches and other storage area networking products.

Server Appliance Distribution revenues. We have recently begun to recognize revenue derived from the sale and support of server appliances we have developed and manufactured in conjunction with our ISV partners. In this case, we are acting as a highly value-added distributor for the ISV, distributing the ISV's software in the form of a co-branded appliance, and acting as the point of sale and support for the device.

Critical Accounting Policies and Estimates

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates and judgments, including those related to: revenue recognition and provisions for sales returns; product warranty obligations; allowance for doubtful accounts; inventory valuation; goodwill, intangible assets and long-lived assets; acquisition accounting; restructuring and other charges; stock compensation expense; and income tax asset valuation. We base our estimates and judgments on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements.

Revenue recognition

We generally recognize revenue from sales of our products upon shipment to customers provided persuasive evidence of the arrangement has been received, the sales price is fixed or determinable, collection of the related receivable is reasonably assured and title and risk of loss have passed to the customer. At the time of a sale transaction, we make an assessment of the collectibility of the amount due from the customer. Revenue is only recognized at that time if we are reasonably assured that collection will occur. In making this assessment, management considers customer creditworthiness and historical payment experience. When we enter into revenue arrangements containing multiple elements, the sale of both the product and post-sales support, we allocate the total revenue to be earned under the arrangement among the various elements based on vendor-specific objective evidence of fair value for each element and revenue is recognized when the revenue recognition criteria for each element is met. If we are not able to derive vendor-specific objective evidence of fair value for each

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component, revenues are deferred and recognized ratably over the period of the support arrangement, which is typically one year. For post-sales support services, revenue is recognized ratably over the period the services are performed. Historically, our OEM Appliance customers have not been granted rights to return our products after the purchase has been made. However, in certain circumstances, we have accepted returns of OEM Appliance products, although we were not contractually obligated to do so. Our Distribution customers are offered a thirty-day right of return. We record a provision for potential returns based on our historical return rates. Material differences may result in the amount and timing of our revenue for any period if management makes judgments or uses estimates that prove to be materially different from actual experiences. We include shipping and handling costs that are reimbursed by our customers, if any, as revenues and cost of revenues.

Product warranty obligations

We offer a warranty on all of our products that generally provide for us to repair or replace any defective products for a period of up to 36 months after shipment. Based upon historical experience and expectation of future conditions, we reserve for the estimated costs to fulfill customer warranty obligations upon the recognition of the related revenue. Significant judgment and estimates are involved in estimating our warranty reserve. To the extent we may experience increased warranty claim activity, increased costs associated with servicing those claims, or use estimates that prove to be materially different from actual claims, our warranty reserve may need to be increased, resulting in decreased gross profits.

Allowance for doubtful accounts

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and each customer's current credit-worthiness, as

determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain an allowance for doubtful accounts based upon historical experience and any specifically identified customer collection issues. In addition, when evaluating the overall adequacy of the allowance for doubtful accounts, we also consider customer concentrations and current economic trends. While actual bad debts recorded against the allowance for doubtful accounts have historically been within expectations and the allowance established, we cannot be sure that we will continue to be able to estimate our future experience with the same success. If the financial condition of our customers were to deteriorate, resulting in their inability to make payments, additional allowances may be required.

Inventories

We value our inventory at the lower of cost (first-in, first-out method) or market. We regularly review inventory quantities on hand and record a reserve for excess and obsolete inventory based primarily on our estimated forecast of product demand and anticipated production requirements in the near future. Any rapid technological changes and future product development could result in an increase in the amount of obsolete inventory quantities on hand. Agreements with certain suppliers to our Distribution business include stock rotation provisions, however, these provisions may not provide us with complete protection from loss due to excess or obsolete inventory. If our estimates of future product demand prove to be inaccurate, additional reserves may be required for incremental excess and obsolete inventory.

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Goodwill, intangible assets and long-lived assets

Goodwill and intangible assets are a result of our acquisition of TidalWire. Goodwill is tested for impairment at least annually. Intangible assets and goodwill are assessed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Any impairment loss will be charged to operations in the period of the loss. We assess the recoverability of long-lived assets, including intangible assets, based on the projected undiscounted future cash flows over the asset's remaining life. The amount of impairment, if any, is measured based on the excess of the carrying value over fair value, determined using projected discounted future operating cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. For goodwill recovery, we compare the carrying value of the segment to which the goodwill is allocated with the segment's fair value. If the carrying value of the segment exceeds its fair value, then the carrying value of that segment's goodwill is compared to the implied fair value of the goodwill and an impairment loss is recorded in an amount equal to that excess, if any. Determining the fair value of individual assets and goodwill may include significant judgments by management. Different assumptions could yield materially different results.

Acquisition accounting

In December 2002, we acquired TidalWire for total consideration of \$17.5 million, which was allocated to net tangible assets and liabilities acquired of \$4.3 million, deferred stock compensation of \$304,000, customer relationships of \$5.1 million and goodwill of \$7.8 million. The fair value of the customer relationships was determined based on the discounted estimated future cash flows

from these relationships. We have estimated that the useful life of these customer relationships would be five years. Significant judgments and estimates are involved in determining the fair value of assets acquired and their useful lives. Different assumptions could yield materially different results.

Restructuring and other charges

Involuntary termination benefits and exit costs are recognized when management approves and commits to a sufficiently detailed plan of termination or exit plan. Management must assess whether costs incurred in connection with involuntary terminations and exit activities meet certain specific requirements to be recorded and classified as restructuring and other costs. During compilation of a plan of termination or exit plan, we make certain assumptions and estimates regarding certain costs contained in these plans based on information gathered from internal and external sources. In addition, charges taken for vacant facilities are recognized when the available information indicates that a loss is probable and estimable. If actual results related to any of these assumptions or estimates were to exceed or not meet our expectations in the future, we may need to adjust certain restructuring and other charges in future reporting periods, resulting in increased or decreased operating expenses.

Stock compensation

In connection with the grant of certain options and restricted stock awards to employees issued prior to our initial public offering in July 2000, we recorded deferred stock compensation within stockholders' equity of \$15.5 million, representing the difference between the estimated fair value of the common stock for accounting purposes and the option exercise price of these options or restricted

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stock awards at the date of grant. Such amount is presented as a reduction of stockholders' equity and is being amortized over the vesting period of the applicable options. Significant judgments and estimates were involved in determining the proper valuation of deferred stock compensation because at the time of grant there was no available market for our common stock. Different assumptions could have yielded materially different results.

Income tax asset valuation

We record deferred tax assets and liabilities based on the net tax effects of tax credits, operating loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we establish a valuation allowance. The valuation allowance is based on our estimate of future taxable income and the period over which our deferred tax assets will be recoverable. Through September 30, 2003, we believe that it is more likely than not that all of our deferred tax assets will not be realized, and, accordingly, we have recorded a valuation allowance against all of our deferred tax assets. If results of operations in the future indicate that some or all of the deferred tax assets will be recovered, the reduction of the valuation allowance will be recorded as a tax benefit during one period or over several periods.

Recent Events

On December 10, 2003, we amended our agreement with EMC regarding the distribution of EMC-approved Fibre Channel HBAs, effective January 1, 2004. This amendment extends the term of the agreement through December 2005 and provides for increased costs to us relating to sales of EMC-approved HBAs. TidalWire, our Distribution operation, has been an authorized distributor of EMC-approved HBAs since 1997. In fiscal 2003, sales of EMC-approved HBAs represented 33% of our total net revenues and 70% of our Distribution revenues. Because of the amendment, there will be a decline in our gross profits related to sales of EMC-approved HBAs, which will in turn have a negative impact on our Distribution gross profits. This decline in Distribution gross profits is expected to have a negative impact on our consolidated gross profits and operating margins beginning in the quarter ending March 31, 2004. We expect that our gross profit from sales of EMC-approved HBAs will be more consistent with the gross profit from our sales of other third party storage networking products, which has historically been between 7% and 12% of the net revenues from these sales. This decrease in our distribution gross profit will begin in the quarter ending March 31, 2004. We are conducting a detailed evaluation of the impact of this amendment on our Distribution segment to determine if the goodwill and intangible assets associated with our acquisition of TidalWire have been impaired. As of September 30, 2003, the current book value of these assets was approximately \$12.1 million. Any impairment charge will be recorded in the three months ending December 31, 2003.

A purported class action lawsuit was filed on December 16, 2003 in the United States District Court in the District of Massachusetts against us, John H. Curtis, our President and CEO, Douglas G. Bryant, our CFO, Vice President, Treasurer and Secretary, and Lawrence A. Genovesi, our Chairman of the Board, relating to the timing of the announcement of the amendment of our agreement with EMC regarding the resale of EMC-approved HBAs. The plaintiffs in the complaint claim that we and

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Messrs. Curtis, Bryant and Genovesi allegedly failed to disclose that we were in the process of renegotiating our distribution contract with EMC while issuing positive statements highlighting our financial performance and related matters. The plaintiffs are seeking unspecified damages. We believe that the action is without merit, and we intend to vigorously defend against the suit.

Results of Operations

The following data summarizes the results of our operations for the past three fiscal years, in thousands and as a percentage of net revenues.

	Fiscal Year Ended September 30,					
	2001		2002		2003	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
Net revenues	\$ 13,515	100.0%	\$ 14,534	100.0%	\$81,243	100.0%

Gross profit (loss)	(19,444)	(143.9%)	2,058	14.2%	16,737	20.6%
Operating expenses	55,230	408.7%	17,775	122.3%	18,686	23.0%
Loss from operations	(74,674)	(552.5%)	(15,717)	(108.1%)	(1,949)	(2.4%)
Net loss	(69,523)	(514.4%)	(14,125)	(97.2%)	(1,385)	(1.7%)

Net Revenues and Gross Profit

The following table summarizes our net revenues and gross profit by reportable segment, in thousands and as a percentage of net revenues:

	Fiscal Year Ended September 30,					
	2001		2002		2003	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
OEM Appliance:						
Net revenues	\$ 13,515	100.0%	\$14,534	100.0%	\$43,289	100.0%
Gross profit (loss)	(19,444)	(143.9%)	2,058	14.2%	9,241	21.3%
Distribution:						
Net revenues	--	--	--	--	\$37,954	100.0%
Gross profit	--	--	--	--	7,496	19.8%
Total net revenues	\$ 13,515	100.0%	\$14,534	100.0%	\$81,243	100.0%
Total gross profit (loss)	\$(19,444)	(143.9%)	\$ 2,058	14.2%	\$16,737	20.6%

Revenues

Prior to our acquisition of TidalWire on December 27, 2002, our revenues were derived from sales of server appliance hardware platforms and related pre-sales integration and supply-chain management services in the United States. In April 2002, our largest OEM Appliance customer, EMC, announced the availability of a product that incorporates one of our customized platforms. Since then, sales of that product have been a major portion of our net revenues. As a result of our acquisition of TidalWire, we also distribute data storage networking connectivity products, consisting primarily of EMC-approved Fibre Channel HBAs, through a channel of VARs and systems integrators. We intend to increase the number of data storage networking and network security products that we distribute, including server appliances developed with our network equipment and ISV partners.

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The increase in net revenues from fiscal 2002 to fiscal 2003 is due primarily to

the addition of distribution sales as a result of our acquisition of TidalWire in December 2002 and due to increased OEM Appliance sales volumes to EMC. Prior to the TidalWire acquisition, there were no Distribution revenues. Sales to EMC represented 47% of our total net revenues and 88% of our OEM Appliance revenues in fiscal 2003.

The increase in net revenues from fiscal 2001 to fiscal 2002 is due to higher OEM Appliance sales volumes as a result of sales to EMC, for which there was no comparable customer in fiscal 2001. Sales to this customer represented 83% of our total net revenues in fiscal 2002. The increase in net revenues in fiscal 2002 was partially offset by a decrease in the average selling price of our server appliance products due to our high concentration of net revenues as well as the absence of license revenues relating to our historical business during the year ended September 30, 2002. In fiscal 2001, 4.9% of our net revenues were generated from license arrangements; however, we did not have any license revenues subsequent to fiscal 2001 and do not anticipate any further license revenues. We expect revenues to increase in fiscal 2004 due primarily to increased appliance sales to our largest customer. In addition, we believe that sales to new OEM Appliance partners and sales of our ISV partners' server appliances will contribute to the expected increase in our net revenues in fiscal 2004.

Gross profit (loss)

Gross profit (loss) represents net revenues recognized less the cost of revenues. Cost of revenues includes cost of materials, manufacturing costs, warranty costs, inventory obsolescence charges and shipping and handling costs. In addition, for internally manufactured server appliance products, cost of revenues includes compensation and related expenses for our manufacturing personnel.

The increase in gross profit in fiscal 2003 versus fiscal 2002 was primarily due to incremental revenues from our recently acquired Distribution business, TidalWire, and increased OEM Appliance sales volumes. To a lesser extent, the increase in gross profit in fiscal 2003 was due to lower manufacturing costs per unit sold. The increase in gross profit in fiscal 2003 was offset in part by significantly increased warranty costs associated with OEM Appliance revenues, resulting primarily from higher estimated costs to fulfill warranties and the increased sales volumes of server appliances.

The increase in gross profit in fiscal 2002 versus 2001 was due primarily to an inventory write-down of approximately \$20.3 million in fiscal 2001 for which there was no corresponding charge in fiscal 2002. The inventory write-down resulted from an unanticipated decline in sales in fiscal 2001, as well as a high level of inventory and firm inventory commitments compared to our reduced expectations for future product sales at that time. In addition to the inventory write-down in fiscal 2001, the increase in gross profit in fiscal 2002 versus fiscal 2001 was also due to an increase in product sales volume, lower per unit materials costs and lower manufacturing costs. A decrease in license revenues in fiscal 2002 partially offset the increase in gross profit.

Our gross profit is affected by the product mix within our OEM Appliance business, our OEM Appliance product pricing as well as the timing, size and configuration of server appliance orders. OEM Appliance gross profit is also affected by the mix of product manufactured internally compared to product manufactured by our contract manufacturer, which carries higher manufacturing costs. Our gross profit is also affected by the relative size of Distribution revenues to OEM Appliance revenues as

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well as the mix of products sold through our Distribution business as each of these products carries a different gross profit as a percentage of revenues. We expect gross profit to continue to be affected by these factors as well as competitive pricing pressure in both the OEM Appliance and Distribution segments and increased costs associated with our recently amended distribution agreement with EMC. As a result, we expect gross profit to increase in absolute dollars due to increased sales volumes and we expect gross profit as a percentage of net revenues to decrease during fiscal 2004.

Operating expenses

The following table presents operating expenses during the periods indicated, in thousands and as a percentage of net revenues:

	Fiscal Year Ended September 30,					
	2001		2002		2003	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
Operating expenses:						
Research and development	\$12,704	94.0%	\$ 4,693	32.3%	\$ 4,114	5.1%
Selling and marketing	18,118	134.1%	3,836	26.4%	6,519	8.0%
General and administrative	7,047	52.1%	4,602	31.7%	5,856	7.2%
Stock compensation	5,800	42.9%	4,291	29.5%	928	1.1%
Restructuring and other charges	10,886	80.5%	353	2.4%	507	0.6%
Amortization of intangible assets	675	5.0%	--	0.0%	762	0.9%
Total operating expenses	\$55,230	408.7%	\$17,775	122.3%	\$18,686	23.0%

Research and development. Research and development expenses consist primarily of salaries and related expenses for personnel engaged in research and development, fees paid to consultants and outside service providers, material costs for prototype and test units and other expenses related to the design, development, testing and enhancements of our server appliance products. We expense all of our research and development costs as they are incurred.

Research and development expenses decreased in fiscal 2003 versus fiscal 2002 due primarily to decreased compensation costs, which decreased as a result of our closure of our Austin, Texas software development center in December 2001 and our June 2002 headcount reduction. These headcount reductions were a result of our transition away from the use of significant proprietary technology in our server appliance products. We have significantly increased the use of standard

off-the-shelf technology in our server appliance products, which has decreased our need for engineering personnel in our product design process. Prior to these headcount reductions, we had 30 people in our engineering group. At September 30, 2003, there were 19 employees in our engineering group. In addition, lower facility-related expenses contributed to the decrease in research and development expenses in fiscal 2003. The decrease in research and development in fiscal 2003 was partially offset by increased prototype and consulting costs incurred in development projects for our OEM Appliance business.

Research and development expenses decreased from fiscal 2001 to fiscal 2002 due primarily to decreased compensation and recruiting costs as the number of employees in our research and development group, which was as high as 85 employees prior to our April and July 2001 restructurings, decreased to 20 employees at September 30, 2002. This decrease in research and

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development expenses was also due to decreases in consulting, prototype and test unit costs as we increased the use of standard off-the-shelf components in our products, which reduced our need to build prototype and test units and allowed us to utilize fewer consultants in our product development process.

We believe that a significant level of investment in product development is required to remain competitive and we expect to continue to devote substantial resources to product development. Our engineering process includes the utilization of standard, off-the-shelf components in our server appliance hardware platforms wherever possible. However, significant internal development efforts are required to fulfill our customers' server appliance needs. As a result, we expect research and development expenses to increase in fiscal 2004, depending on actual server appliance development project activity.

Selling and marketing. Selling and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in sales, marketing, business development and customer support functions, as well as costs associated with travel and marketing programs.

The increase in selling and marketing expenses in fiscal 2003 versus fiscal 2002 was due to increased compensation costs as sales, marketing, business development and customer support personnel increased from 11 employees at September 30, 2002 to 41 employees at September 30, 2003, which was primarily due to our acquisition of TidalWire in December 2002.

Selling and marketing expenses decreased in fiscal 2002 versus fiscal 2001 due primarily to decreased compensation and recruiting costs as the number of employees in our sales, marketing and customer support group, which was as high as 98 employees prior to the April and July 2001 restructurings, decreased to 11 employees at September 30, 2002. The decrease in selling and marketing expenses in fiscal 2002 was also due to a significant reduction in spending on marketing programs, as we did not exhibit at any trade show or incur advertising expenses in fiscal 2002. To a lesser extent, decreased travel costs also contributed to the decrease in selling and marketing expenses during fiscal 2002 as a result of the decrease in sales, marketing and customer support personnel.

We expect selling and marketing expenses to increase in absolute dollars in fiscal 2004 as we continue to expand our sales and marketing efforts to further increase our market presence and grow our revenues. However, we expect selling

and marketing expenses to decrease as a percentage of net revenues in fiscal 2004, depending on revenue growth.

General and administrative. General and administrative expenses consist primarily of salaries and other related costs for executive, finance, accounting, information technology, facilities and human resources personnel, as well as accounting, legal, audit and tax fees, insurance, administrative expenses associated with operating as a public company and bad debt expenses.

The increase in general and administrative expenses in fiscal 2003 versus fiscal 2002 is primarily attributable to increased compensation costs as general and administrative personnel increased from 13 at September 30, 2002 to 20 at September 30, 2003, primarily due to our TidalWire acquisition. The increase in general and administrative expenses in fiscal 2003 is also due to increased legal, audit and tax and insurance expenses due to the rising costs associated with our operation as a public company

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and our defense of a lawsuit related to our acquisition of TidalWire. In the first quarter of fiscal 2003, we recorded a reserve against certain receivables from our sub-tenant due to the financial condition of this sub-tenant, which contributed to the increase in general and administrative expenses in fiscal 2003. The increase in general and administrative expenses in fiscal 2003 was offset in part by our reversal of reserves against shareholder notes receivable in the first quarter of fiscal 2003 and a charge due to our settlement of a lawsuit brought against us by a former employee in the second quarter of fiscal 2002.

The decrease in general and administrative expenses in fiscal 2002 versus fiscal 2001 is primarily due to lower bad debt expenses in fiscal 2002. In fiscal 2001, we recognized a significant bad debt expense as a result of the economic down-turn during that time period, which had an adverse effect on our customers. The decrease in general and administrative expenses in fiscal 2002 is also attributable to lower compensation and recruiting costs as the number of employees in our general and administrative group, which was as high as 34 employees prior to the April and July 2001 restructurings, decreased to 13 employees as of September 30, 2002. In addition, the decrease in general and administrative expenses in fiscal 2002 was also due to lower consulting and professional service fees and was partially offset by a charge due to our settlement of a lawsuit brought against us on by a former employee.

We expect general and administrative expenses to increase in absolute dollars in fiscal 2004 and we expect general and administrative expenses to decrease as a percentage of revenues in fiscal 2004 depending on revenue growth.

Stock compensation. We recorded deferred stock compensation on our balance sheet of \$15.5 million in connection with stock option and restricted stock grants to our employees and directors that were granted between February 1, 1999 and June 30, 2000. This amount represents the difference between the exercise price and the deemed fair value of our common stock for financial reporting purposes at the date of grant. We are amortizing this stock compensation over the vesting period of the related options. All options granted subsequent to June 30, 2000 have been issued with exercise prices equal to the fair market value of our common stock and, accordingly, no additional deferred compensation has been recorded. Through September 30, 2003, we amortized \$8.0 million to

stock compensation expense and \$7.1 million of deferred stock compensation has been reversed due to the cancellation of options for terminated employees.

In November 2000, we recorded \$6.4 million of deferred compensation on our balance sheet as a result of restricted stock issued to the former employees of IP Performance, Inc., which was acquired by us in November 2000. In December 2001, we terminated the employment of all of the former IP Performance employees. In accordance with the restricted stock agreements, all of the remaining unvested restricted stock vested upon termination. As a result, we recognized the remaining deferred stock compensation of approximately \$3.5 million in December 2001.

In connection with our acquisition of TidalWire, we assumed all of TidalWire's outstanding options, which converted into options to purchase 1,035,033 shares of our common stock. We recorded approximately \$304,000 of deferred stock compensation on our balance sheet related to unvested options. This amount represents the difference between the exercise prices and the fair market value of our common stock on the option conversion date. We are amortizing this deferred stock compensation

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over the remaining vesting period of the related options. Through September 30, 2003, we amortized \$178,000 to stock compensation expense and \$62,000 of deferred stock compensation has been reversed due to the cancellation of options for terminated employees.

The decrease in stock compensation expense in fiscal 2003 versus fiscal 2002 is due to the accelerated amortization of \$3.5 million of deferred stock compensation recorded in December 2001 as a result of our closure of our Austin, Texas development center and the termination of employee stockholders as a result of that facility closure.

The decrease in stock compensation expense in fiscal 2002 versus fiscal 2001 was due primarily to the reversal of deferred stock compensation associated with cancelled employee stock options in connection with headcount reduction undertaken in the fourth quarter of fiscal 2001. This decrease in stock compensation expense was offset by the charge taken in connection with our Austin, Texas development center closure in December 2001.

We expect stock compensation amortization of approximately \$430,000 in fiscal 2004 and approximately \$3,000 in fiscal 2005. The amount of stock compensation expense to be recorded in future periods could change if restricted stock or options for accrued but unvested compensation are forfeited or if additional deferred stock compensation is recorded in future periods.

Restructuring and other charges. In the first quarter of fiscal 2003, we recorded a charge to operations of \$507,000. This charge was comprised entirely of future lease and lease-related payments and resulted from the continued vacancy of certain leased facilities and the expected future vacancy of certain leased facilities that were occupied by a sub-tenant. This change in estimated sub-lease income resulted in a charge of \$914,000 and was determined through an analysis of the real estate market in and around these facilities, the likelihood that these facilities could be sub-leased during the remainder of the existing lease terms and the financial condition of the sub-tenant. In the second quarter of fiscal 2003, we received unanticipated sub-lease income of

approximately \$30,000 from our existing sub-tenant. As a result, we recorded a \$30,000 reversal of the associated restructuring accrual as a decrease to restructuring and other charges. In October 2003, we amended the lease agreement on our facilities, extending the term of our primary office and manufacturing space and eliminating the remaining lease term on space occupied by a sub-tenant, as of October 31, 2003. This lease amendment required us to pay a termination fee of \$54,000. In addition, we revised our estimates as to the expected future occupancy by us of previously vacant leased space. The lease amendment, and our revised estimate as to the future occupancy of previously vacant leased space, resulted in a reversal of approximately \$377,000 of restructuring accrual in the fourth quarter of fiscal 2003. We believe this lease amendment will result in a reduction to operating expenses of approximately \$218,000 in fiscal 2004 and approximately \$60,000 in fiscal 2005.

In June 2002, in an effort to further streamline operations, we implemented an additional restructuring whereby we reduced our workforce by 13 employees, which impacted employees in all of our departments. The implementation of this reduction in workforce resulted in a charge of \$353,000 to operations, which was comprised entirely of employee-related charges, including severance payments to terminated employees. We believe this restructuring resulted in cost savings of approximately \$1.3 million in fiscal 2003.

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During fiscal 2001, we undertook two restructurings of our operations, the first of these restructurings occurred in April 2001 and the second in July 2001. In the April 2001 restructuring, we sought to better align our operating expenses with reduced revenues, and as a result of the implementation, we recorded a charge to operations of \$2.8 million. This charge was due to a reduction in workforce from 243 employees to 170 employees, the curtailment of a planned expansion into leased facilities and other items. This charge included approximately \$1.0 million for employee related costs including severance payments to terminated employees and stock option compensation expense related to modifications of certain stock options held by terminated employees, approximately \$1.3 million to write off certain assets related to facilities that we would not be occupying and approximately \$530,000 primarily related to non-refundable deposits on tradeshowes we did not attend as well as costs for certain other non-cancelable sales and marketing commitments. The July 2001 restructuring was the result of an intensive review of our business, which resulted in a refocus of the sales strategy toward strategic partnerships with network equipment providers and ISVs and a discontinuation of much of the customized hardware and software that was previously included in our products. As a result of the implementation of the July 2001 restructuring, we recorded a charge to operations of approximately \$6.9 million. This charge included approximately \$1.7 million of employee related costs as we reduced our workforce by 65 employees, approximately \$2.2 million as a result of our disposal of certain property and equipment, approximately \$2.0 million to write off goodwill and intangible assets which were deemed to be impaired, approximately \$618,000 of facility costs associated with non-cancelable operating leases for space which would not be occupied and approximately \$363,000 of other charges. In addition to the April 2001 and July 2001 restructurings, in March 2001 we recorded a charge due to the retirement of fixed assets related to our WebEngine Blazer product line. These fixed assets had a total net book value of approximately \$1.2 million and consisted primarily of computer equipment previously utilized in the production and sales of the WebEngine Blazer, one of our previous generation web content server appliance products. The total of the

restructuring and other charges detailed above was approximately \$10.9 million recorded for the year ended September 30, 2001. The reduction in our workforce implemented during the year ended September 30, 2001 impacted employees in all of our groups, including manufacturing, research and development, selling and marketing and general and administrative. We realized approximately \$37.7 million in cost savings in fiscal 2002 as a result of our fiscal 2001 restructurings.

Amortization of intangible assets and goodwill. In connection with our acquisition of TidalWire in December 2002, we engaged an independent valuation firm to evaluate the intangible assets generated as a result of the acquisition. As a result of this valuation work, we recorded approximately \$5.1 million of intangible assets attributable to TidalWire's existing customer relationships as of December 27, 2002. We estimated the useful life of the relationships to be five years and as such, we are amortizing the related intangible assets on a straight-line basis over five years. As noted under "Recent Events" above, we amended our agreement with EMC regarding our distribution of EMC-approved Fibre Channel HBAs. As a result of this amendment, our gross profits from sales of EMC-approved HBAs will decrease beginning in the three months ending March 31, 2004. We are evaluating the impact that this decrease in gross profits will have on our Distribution segment and the fair value of the goodwill and intangible assets recorded as a result of our acquisition of TidalWire. This evaluation may result in an impairment of goodwill and intangible assets and a charge to operations in the three months ending December 31, 2003.

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In connection with our acquisition of IP Performance in November 2000, we recorded goodwill and intangible assets of \$2.7 million, of which we amortized \$675,000 in the year ended September 30, 2001. During the year ended September 30, 2001, we completed an intensive review of our business, which resulted in the implementation of a restructuring plan. As a result of this restructuring and an assessment of expected future cash flows, we determined that the recoverability of intangible assets resulting from our purchase of IP Performance, Inc. was unlikely. Accordingly, we recognized an impairment charge in the July 2001 restructuring for the full amount of the remaining unamortized intangible assets, approximately \$2.0 million, during the year ended September 30, 2001.

Unless we determine that our intangible assets have been impaired as a result of the "Recent Events" noted above, we expect quarterly amortization of intangible assets of approximately \$254,000 through December 31, 2007. However, in the event that our intangible assets have been impaired, our quarterly amortization of intangible assets could be materially different.

Interest and Other Income (Expense), net

Interest and other income (expense), net has decreased from \$5.2 million in fiscal 2001 to \$1.6 million in fiscal 2002 and to \$564,000 in fiscal 2003. These decreases were due to lower average interest rates earned on our cash equivalents and lower average cash, cash equivalents and short-term investments balances as a result of the utilization of cash and cash equivalents to fund our net operating losses incurred since our initial public offering in July 2000 and to fund our acquisition of TidalWire in December 2002.

Liquidity and Capital Resources

Cash used in operating activities has declined from \$32.9 million in fiscal 2001, to \$15.7 million in fiscal 2002 and to \$5.4 million in fiscal 2003. Our declining use of cash for operations is a result of the restructuring activities undertaken in fiscal 2001 and the revenue and gross profit growth experienced as a result of our acquisition of TidalWire and the increased revenue from our OEM Appliance business. Our fiscal 2001 restructuring activities allowed us to lower our operating cash usage by first better aligning our operating expenditures with lower fiscal 2001 and fiscal 2002 revenues and second by implementing a change in business strategy. Our current OEM Appliance business strategy requires fewer employees and has allowed us to grow our server appliance sales to \$43.3 million in fiscal 2003, greater than the \$43.1 million of revenues recorded in fiscal 2000, prior to the downturn in the economy. In addition, the acquisition of TidalWire further enhanced our value proposition and provided us with an additional \$38.0 million of revenues and \$7.5 million in gross profit in fiscal 2003 and has helped us reach profitability in our third and fourth fiscal quarters of 2003, which, has allowed us to continually decrease the amount of cash used in our operations. Cash used in operations in each of the past three fiscal years was primarily the result of net losses of \$69.5 million in fiscal 2001, \$14.1 million in fiscal 2002 and \$1.4 million in fiscal 2003. In addition, cash used in operations is also due to net working capital investments, which provided cash of \$18.9 million in fiscal 2001 due to a sharp decline in accounts receivable and inventories as a result of lower fiscal 2001 revenues. In fiscal 2002 and 2003, our net working capital investment was a use of cash of \$7.5 million and \$7.4 million, respectively, due primarily to the growth of inventory and accounts receivable, which was offset in part, in fiscal 2003 by the growth of accounts payable.

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Non-cash adjustments to reconcile net loss to net cash used in operations were \$17.7 million in fiscal 2001, \$6.0 million in fiscal 2002 and \$3.4 million in fiscal 2003. Non-cash charges include depreciation, amortization, provision for doubtful accounts, non-cash restructuring charges and stock compensation expense. We will continue to make what we believe to be necessary working capital investments to continue to grow our business and we expect to continue to use cash in our operating activities in fiscal 2004.

In fiscal 2000 and 2001 we made significant investments in property and equipment as we grew our business. These investments totaled approximately \$10.8 million, or 19% of total fiscal 2000 and 2001 net revenues, and included improvements to our headquarters in Canton, Massachusetts, including our production facility, and investments in production equipment. We have been able to leverage these earlier capital investments as we have grown our restructured server appliance business and, as a result, our investments in property and equipment have declined as a percentage of net revenues to \$318,000, or 2.2% of net revenues in fiscal 2002, and \$782,000, or 1.0% of net revenues in fiscal 2003. In fiscal 2003, we used approximately \$13.2 million of cash, including transaction costs, in connection with our acquisition of TidalWire in December 2002. Because TidalWire, now part of our Distribution segment, utilizes the warehousing and fulfillment services of a third-party, our Distribution business does not require a significant capital investment at this time. We expect to invest in property and equipment in fiscal 2004 as we continue to grow our business. However, depending on revenue growth in fiscal 2004, we expect our fiscal 2004 property and equipment purchases to be relatively consistent to fiscal 2003 as a percentage of net revenues. In addition to investments in

property and equipment and our acquisition of TidalWire, cash used in our investing activities included our 2002 purchase of \$8.5 million of short-term investments. We purchased these short-term investments due to declining interest rates on our available cash and cash equivalents. However, as interest rates continued to decline in fiscal 2003, the additional interest earned on our short-term investments was not enough for us to continue with these short-term investments and we sold them in fiscal 2003 with a gain \$46,000. Due to the continued low level of interest rates, and our conservative investment strategy of capital preservation, we do not anticipate investments in long-term investments in fiscal 2004 at this time. In fiscal 2001, we guaranteed a bank loan to our Chairman that was collateralized by his holdings in our common stock thereby restricting approximately \$1.1 million of our cash. This guarantee was settled in fiscal 2003 through the combination of a cash repayment to us from the bank of \$83,254 and the automatic conversion of the remaining guarantee of \$968,596 into a note receivable to us from our Chairman. As a result of Company policy, as well as the Sarbanes-Oxley Act of 2002, we will not provide guarantees in any form to officers or directors in the future. In addition, current company policy prohibits officers from collateralizing personal debt with Company stock.

Our financing activities since inception have been primarily from the sale of equity securities. Financing activities have been our principal source of cash since fiscal 1997 and, prior to our initial public offering in fiscal 2000, we raised approximately \$37.3 million, net of offering costs, from the issuance of preferred stock. In July of 2000, we completed our initial public offering by selling a total of 7,475,000 shares of common stock at \$17 per share and raised approximately \$116.9 million, net of offering costs and underwriting fees totaling approximately \$10.2 million. Upon the completion of our initial public offering all shares of preferred stock were converted into common stock. In addition to equity financing, we have generated cash as a result of employee stock option and stock purchase plan

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activity of \$483,000 in fiscal 2001, \$135,000 in fiscal 2002 and \$903,000 in fiscal 2003. We expect employee stock option and stock purchase plan activity to continue in fiscal 2004, however we cannot predict its level given the volatility of capital markets. In addition, the primary financing activity that we have engaged in that has been a use of cash was our \$5.0 million common stock repurchase program. This program was approved by our board of directors in August 2001. Our stock repurchase program authorized us to repurchase our common stock from time to time on the open market or in non-solicited privately negotiated transactions. Through the end of this program in November 2002, we repurchased approximately 4,706,492 shares of our common stock at an average price of \$1.00 per share for a total of approximately \$4.7 million of cash. In addition, from August 2001 through January 2003, we repurchased 1,163,250 shares of our common stock at an average price of \$1.24 per share in exchange for the retirement of approximately \$1.4 million of debt, including accrued interest, from certain current and former employees and officers and our Chairman. In addition, we received cash repayments from our Chairman of \$4,000 related to a note receivable resulting from his purchase of restricted stock in 1999 and \$456,000 of notes receivable resulting from the conversion of our 2001 guarantee of a bank loan to him. Since the adoption of the Sarbanes-Oxley Act of 2002, we have not made any loans to any officers or directors. All of our stock repurchases were recorded on our balance sheet as treasury stock at our cost to repurchase the stock. We used 3,331,043 shares of our treasury stock, which had

an average cost of \$0.96 per share, to help fund our acquisition of TidalWire in December 2002.

As a result of the restructurings that we implemented in our fiscal 2001, 2002 and 2003, we are obligated to make additional cash payments of approximately \$218,000 over the next twelve months and \$60,000 thereafter for lease and facility-related payments. We anticipate that funds required to make all restructuring payments will be available from our current working capital.

In October 2003, we amended our operating lease on our headquarters. The following table sets forth future payments that we were obligated to make under our amended lease commitments (in thousands):

Fiscal year ending September 30,					

Contractual obligation	2004	2005	2006	2007	Total
Operating leases	\$ 610	\$ 610	\$ 610	\$ 305	\$2,135

As noted under "Recent Events" above, we amended our agreement with EMC regarding our distribution of EMC-approved Fibre Channel HBAs. As a result of this amendment, our gross profits from sales of EMC-approved HBAs will decrease beginning in the three months ending March 31, 2004. Any reduction in our gross profits will have a negative impact on our future liquidity and capital requirements.

Our future liquidity and capital requirements will depend upon numerous factors, including:

Ythe timing and size of orders from our largest customer;

Your ability to form an adequate number of strategic partnerships with ISVs, resellers, integrators and suppliers;

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Your ability to distribute server appliances for software companies through our newly acquired Distribution business;

Your ability to maintain and increase the revenues and gross margins from our newly acquired Distribution business;

Ythe level of success of our ISV partners in creating demand for their products in the form of an appliance;

Ythe level of success of our strategic OEM Appliance partners in selling server appliance solutions that include our server appliance hardware platforms;

Ythe costs and timing of product engineering efforts and the success of these efforts; and

Ymarket developments.

We believe that our available cash resources, including cash and cash equivalents, and cash that we expect to generate from sales of our products will be sufficient to meet our operating and capital requirements through at least the next twelve months. After that, we may need to raise additional funds. We may in the future seek to raise additional funds through borrowings, public or private equity financings or from other sources. There can be no assurance that additional financing will be available at all or, if available, will be on terms acceptable to us. If additional financing is needed and is not available on acceptable terms, we may need to reduce our operating expenses.

Related Party Transactions

In January 2001, we deposited \$1.1 million of cash with a bank to guarantee a personal loan of Lawrence A. Genovesi, our current Chairman and former President, Chief Executive Officer and Chief Technology Officer. This guarantee was made in order to avoid significant sales of our stock by Mr. Genovesi as a result of a margin call on a personal loan collateralized by Mr. Genovesi's holdings of our stock. In conjunction with our guarantee of this loan, we entered into an agreement whereby Mr. Genovesi agreed to reimburse us for any obligations incurred by us under the guarantee. On January 6, 2003, the bank applied \$968,596 of our funds that were on deposit with the bank in satisfaction of all amounts due to the bank from Mr. Genovesi and refunded \$83,254 to us. On January 27, 2003, Mr. Genovesi repaid us \$974,168 to satisfy his obligations to us in full under the reimbursement agreement. Of that amount, \$456,276 was paid in cash and \$517,892 was paid with the proceeds from the repurchase by us of 391,128 shares of our common stock owned by Mr. Genovesi in a private transaction.

During fiscal year 2002, we repurchased 328,572 shares of common stock held by Mr. Genovesi at a cost of \$248,000. Of the purchase price, \$203,000 was applied against Mr. Genovesi's outstanding loans due to us, while the remaining \$45,000 was paid in cash to Mr. Genovesi. Mr. Genovesi also repaid \$15,000 due to us under his remaining outstanding loans. On January 27, 2003, Mr. Genovesi, repaid to us a recourse note payable of \$22,500 with proceeds from our repurchase of 17,070 shares of our common stock owned by Mr. Genovesi.

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In April 2001, we entered into five recourse loans with certain of our officers and employees at that time totaling approximately \$736,000. We entered into these loan agreements to avoid substantial sales of our common stock by these individuals as a result of their alternative minimum tax obligations incurred as a result of their exercise of common stock options. The loans had an interest rate of 4.63% per year and were due, as amended, in September 2002. These officers and employees pledged to us all shares of our common stock owned by them, all common stock options held by them and all proceeds received by them on the sale of either our common stock or common stock options. During fiscal year 2002, we received proceeds from loans principal and interest payments of approximately \$30,000; we repurchased 260,777 shares of common stock as repayment for principal and interest for an additional \$267,000. In January 2003, the remaining loans of approximately \$489,000 were repaid in full, including accrued interest, through our repurchase of 278,600 shares of our common stock.

In connection with our acquisition of TidalWire, we paid \$1,144,615 in cash to Ascent Venture Partners and \$2,205,828 in cash to HarbourVest Partners, two of our substantial stockholders. At the time of the acquisition, Ascent and HarbourVest owned approximately 18.1% and 16.3% of our outstanding common stock, respectively. Ascent and HarbourVest also owned 12.9% and 24.9% of the outstanding common stock of TidalWire, respectively. Pursuant to the terms of the merger agreement, we issued 480,706 shares and 926,386 shares of our common stock previously held as treasury stock to Ascent and HarbourVest, respectively, and made the aforementioned cash payments to Ascent and HarbourVest in exchange for all of the TidalWire common stock held by Ascent and HarbourVest.

In connection with the TidalWire acquisition, we engaged Akibia, Inc. to provide certain warranty fulfillment services. Akibia charges us a fee for these services based upon sales of certain of our products. A director of ours is also a director of PSI Holding Group, Inc. the parent company of Akibia. At the time this relationship was established, Ascent and HarbourVest each owned greater than 5% of our outstanding stock and greater than 5% of the outstanding stock of PSI. In the twelve months ended September 30, 2003, we recognized \$972,000 of expense as a result of our agreements with Akibia. In addition, TidalWire had certain agreements with Akibia related to administrative and accounting services and leased certain facilities from Akibia. These agreements terminated in March 2003. Payments related to these agreements by us during fiscal 2003 totaled \$53,000. At September 30, 2003, we had amounts due to Akibia of \$193,000.

Recent Accounting Pronouncements

In November 2002, the FASB issued FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34 ("FIN 45"). FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN 45 does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. It also incorporates, without change, the guidance in FASB Interpretation No. 34, "Disclosure of Indirect Guarantees of Indebtedness of Others," which is being superseded. The disclosure provisions of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002.

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and the provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor's year-end. The adoption of FIN 45 did not have a material impact on our financial position or results of operations.

In November 2002, the Emerging Issues Task Force of the FASB reached a consensus on Issue 00-21, Accounting for Revenue Arrangements with Multiple Deliverables ("EITF 00-21"). EITF 00-21 requires that for revenue arrangements with multiple deliverables, those deliverables be divided into separate units of accounting if the deliverables meet certain criteria as defined by EITF 00-21. Arrangement consideration is to be allocated among the separate units of accounting based on their relative fair values and revenue recognition decisions should be

considered separately for each separate unit of accounting. EITF 00-21 is effective for all arrangements entered into in fiscal periods beginning after June 15, 2003, with early adoption permitted. The adoption of EITF 00-21 did not have a material impact on our financial position or results of operations.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS 150"). SFAS 150 establishes standards for how an issuer of equity classifies and measures on its balance sheet certain financial instruments with characteristics of both liabilities and equity. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003 and for existing financial instruments after October 1, 2003. The adoption of SFAS 150 is not expected to have an impact on our financial position or our results of operation.

FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

The risks and uncertainties described below are not the only ones we are faced with. Additional risks and uncertainties not presently known to us, or that are currently deemed immaterial, may also impair our business operations. If any of the following risks actually occur, our financial condition and operating results could be materially adversely affected.

Risks of dependence on one strategic partner.

We derive a significant portion of our revenues from EMC and our revenues may decline significantly if this customer cancels or delays purchases of our products, terminates its relationship with us, or exercises certain of its contractual rights.

In the years ended September 30, 2003 and 2002, sales directly to EMC, our largest customer, accounted for 47% and 83% of our total net revenues and 88% and 83% of our OEM Appliance revenues, respectively. Primarily all of these sales are attributable to one OEM Appliance product pursuant to a non-exclusive contract. We anticipate that our future operating results will continue to depend heavily on sales to, and our relationship with, this customer. Accordingly, the success of our business will depend, in large part, on this customer's willingness to continue to utilize our server appliance solutions in its existing and future products. Further, our financial success is dependent upon the continued success of the product we currently sell to this customer and the continued growth, viability and financial stability of this customer, whose industry has experienced rapid technological

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change, short product life cycles, consolidation and pricing and margin pressures. A significant reduction in sales to this customer, or significant pricing and margin pressures exerted on us by this customer, would have a material adverse effect on our results of operations. In addition, if this customer delays or cancels purchases of our products, our operating results would be harmed and our ability to accurately predict revenues, profitability and cash flows would decrease.

Under the terms of our non-exclusive contract with our largest customer, this customer the right to enter into agreements with third parties for similar products, our largest customer is not obligated to purchase any minimum quantity

of products from us and may choose to stop purchasing from us at any time, with or without cause. In addition, this customer may terminate the agreement in the event that we attempt to assign our rights under the agreement to another party without this customer's prior approval. Furthermore, in the event that we default on certain portions of the agreement, this customer has the right to manufacture certain products in exchange for a mutually agreeable royalty fee. If any of these events were to occur, or if this customer were to delay or discontinue purchases of our products, as a result of dissatisfaction or otherwise, our revenues and operating results would be materially adversely affected and our reputation in the industry might suffer and our ability to accurately predict revenues, profitability and cash flows would decrease.

A significant portion of our current Distribution revenues are attributed to sales of EMC-approved Fibre Channel HBAs. The December 2003 amendment of our agreement with EMC regarding the sale of such HBAs will result in lower gross profits on such sales, which may cause our business to suffer. In addition, our business would also suffer if we were no longer authorized to distribute EMC-approved HBAs, if additional distributors were authorized to distribute such HBAs or if the gross profits we derive from these sales were further reduced.

In the year ended September 30, 2003, approximately 70% of our Distribution revenues, or 33% of our total net revenues, were derived from sales of Fibre Channel HBAs approved for configuration in certain EMC data storage networking products. We are one of two North American distributors that EMC has authorized to distribute EMC-approved Fibre Channel HBAs. Sales of these HBAs have historically had a higher gross profit however, as a result of an amendment to our agreement with EMC regarding our sales of these HBAs, the costs to us to sell such HBAs will increase in the three months ending March 31, 2004. As a result of this increase in our costs, gross profits on our sales of EMC-approved HBAs will decline beginning in the three months ended March 31, 2004. We expect that our gross profit from sales of EMC-approved HBAs will be more consistent with our sales of other third party storage networking products, which have historically been between 7% and 12% of the net revenues from these sales. This decline in our Distribution gross profit will begin in the quarter ending March 31, 2004. This decline will negatively impact our Distribution segment business operations and could cause our other business operations to suffer. For instance, higher costs to us on sales of EMC-approved HBAs may not allow us to reduce prices to the level of our competitors, which could cause us to lose customers who purchase EMC-approved HBAs from us as well as other products. The loss of customers of our Distribution segment could cause our Distribution segment's revenues to decline and could limit our ability to distribute server appliances, which would severely damage our business. In addition, EMC is not contractually prohibited from increasing or decreasing the number of authorized North American distributors of these HBAs. If EMC were unwilling to permit us to resell such HBAs, or if it were to expand its relationships with other distributors, our relationships with

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VARs and systems integrators of data storage network components could be materially adversely affected and our reputation would suffer. In addition, if we were no longer permitted to resell EMC-approved HBAs, we could lose customers of our Distribution segment, which could cause our Distribution segment's revenues to decline and could limit our ability to distribute server appliances, which would severely damage our business.

Risks related to business strategy.

Our future success is dependent on our ability to generate significant revenues from relationships with network equipment providers and ISVs.

A major component of our business strategy is to focus our selling and marketing efforts on indirect sales through relationships with network equipment providers and ISVs. To date, we have not entered into a significant number of definitive agreements with network equipment providers or ISVs. Even if we are successful in developing relationships with a significant number of network equipment providers and ISVs, we will be reliant on our partners' ability to create demand for their server appliance products. If we engage network equipment or ISV partners whose products are technologically inferior to competitive products or who do not commit an adequate level of resources to promoting their server appliance products, sales of these server appliance solutions may be limited and our revenues and operating results may suffer. In addition, our business strategy requires us to expend a significant level of engineering, selling and marketing resources for each of our network equipment or ISV partners. If we fail to generate enough revenues to offset the financial demands that our strategy places on our business, our future operating results will suffer.

If we are unsuccessful in our efforts to sell our server appliance solutions by leveraging our TidalWire Distribution operation, our revenues and operating results may suffer.

One of the reasons that we acquired TidalWire was to utilize TidalWire's distribution channel to sell the server appliance solutions developed for our current and future server appliance distribution ISV partners. However, we have limited experience in selling and marketing server appliances through this newly acquired distribution channel. To successfully sell such server appliance solutions through our Distribution operation we must work extensively with these ISV partners' selling and marketing personnel and our VAR and systems integrator partners. We may find that the amount of time and resources that are required to effectively sell our partners' server appliance solutions through our Distribution operation is more significant and costly than was originally planned. If we are unable to generate sufficient revenues by leveraging our Distribution operation to increase sales of our server appliance solutions in a cost effective and timely manner, our operating results may suffer and we may determine that we need to discontinue this component of our business strategy.

If we fail to expand our network of resellers, or fail to add server appliances to our distribution product line or expand into the network security market, our revenues and operating results may be adversely affected.

A key component of our business strategy is to broaden our Distribution business by, among other things, expanding our network of VARs and systems integrators, selling a portion of our server appliance solutions to our network of VARs and systems integrators and focusing our sales and marketing efforts in both the data storage and network security markets. If we fail to increase the

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number of resellers, retain and expand relationships with existing resellers, or fail to add additional products to our distribution product line, our revenues and operating results may be adversely affected. In addition, in order to expand our business into the network security market, we may need to expend substantial

resources and it may take us longer to establish strategic partnerships due to our lack of experience in this market. If we are not successful in expanding in this market, our revenue growth may be limited and our operating results may be adversely affected.

Our business could be harmed if we fail to adequately integrate technologies or the operations of the businesses that we may acquire in the future.

As part of our strategy, from time to time we expect to review opportunities to invest in complementary businesses, products or technologies that would expand the breadth of our markets or enhance our technical capabilities, or that may otherwise offer growth opportunities. We have made in the past, and may make in the future, acquisitions of or significant investments in businesses, products or technologies. Any future acquisitions present numerous risks, including:

Ydifficulties in integrating the operations, technologies, products and personnel of the acquired companies and realizing upon the anticipated synergies of the combined businesses;

Ymanaging the risks of entering markets or types of businesses in which we have limited or no direct experience;

Yunanticipated problems or latent liabilities, such as problems with the quality of the installed base of the target company's products; and

Ydiversion of management's attention from the core operations of the business.

If we acquire a new business, we may be required to expend significant funds, incur debt, issue additional securities or assume liabilities, any of which may negatively affect our operations and be dilutive to our stockholders. In addition, such acquisitions could result in one-time charges related to acquisition costs, severance costs, employee retention costs and in-process research and development. The failure to adequately address these risks could harm our business and financial results.

Risks related to financial results.

We have a history of losses and may continue to experience losses in the future, which could cause the market price of our common stock to decline.

Since our inception, we have incurred significant net losses and, although we were profitable in the three and six months ended September 30, 2003, we could incur net losses in the future. We believe that any future growth will require us to incur significant engineering, selling and marketing and administrative expenses. As a result, we will need to generate significant revenues to sustain profitability. In addition, lower gross profit from our sales of EMC-approved HBAs beginning in the quarter ending March 31, 2004, as a result of our recently amended distribution agreement with EMC, will negatively impact our profitability. As a result of these factors, we cannot be certain that we will be able to sustain profitability in the future. If we do not maintain profitability, the market price for our common stock may decline.

Our quarterly revenues and operating results may fluctuate seasonally, which could result in decreased revenue from quarter to quarter, which in turn could cause the market price of our common stock to decline.

Seasonal fluctuations in revenue and operating results in the data storage networking industry are common. In particular, this industry typically experiences increased orders and resulting revenues in the quarter ended December 31, and a subsequent decline in orders and resulting revenues during the quarter ended March 31. With a substantial amount of our revenue derived from data storage networking products, we may experience significant quarter-to-quarter fluctuations in revenues and operating results due to customers timing their orders based on their own quarterly financial considerations. Accordingly, we believe that quarter-to-quarter comparisons of results of operations are not necessarily meaningful and should not be relied upon as an indication of future performance. Nonetheless, the market price of our common stock could decline in response to these variations.

Our quarterly revenues and operating results may also fluctuate for reasons other than seasonality, which could cause our operating results to fall below expectations and thus impact the market price of our common stock.

In addition to seasonality issues, our quarterly revenues and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. None of our customers are obligated to purchase any quantity of our products in the future nor are they obligated to meet forecasts of their product needs. Our operating expense levels are based in part on expectations of future revenues and gross profits. If revenues or gross profits in a particular quarter do not meet expectations, operating results could suffer and the market price of our common stock could decline. Factors affecting quarterly operating results include:

Ythe timing and size of orders from customers, particularly our largest customer;

Ythe loss of key suppliers or customers;

Ythe mix of OEM appliance revenues and Distribution revenues and the product mix within each;

Ythe ability to expand our production capacity;

Ythe mix of product manufactured internally and by our contract manufacturer;

Ythe availability of products from suppliers;

Yprice competition;

Ychanging global economic conditions; and

Ythe timing of expenditures in anticipation of increased revenues.

In addition, as a result of our amended agreement with EMC regarding our sales of EMC-approved HBAs, our costs incurred in connection with sales of such HBAs

will increase beginning in the three months ending March 31, 2004. As a result, our gross profits on such sales will begin to decrease in the three months ending March 31, 2004. This will increase the difficulty in predicting our quarterly revenues and gross profits, which could have a negative impact on our business.

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If the products and services that we sell become more commoditized and competition in the server appliance, data storage and network security markets continues to increase, then our gross profit as a percentage of net revenues may decrease and our operating results may suffer.

Products and services in the server appliance, data storage networking and network security markets may be subject to further commoditization as these industries continue to mature and other businesses introduce additional competing products and services. The gross profit as a percentage of revenues of our products may not grow to our targeted gross profit percentages or may even decrease, in response to changes in our product mix, competitive pricing pressures, or new product introductions into the server appliance and data storage markets. If we are unable to offset decreases in our gross profits as a percentage of revenues by increasing our sales volumes, operating results will decline. Changes in the mix of sales of our products, including the mix of higher margin sales of products sold in smaller quantities and somewhat lower margin sales of products sold in larger quantities, could adversely affect our operating results for future quarters. To maintain our gross profits, we also must continue to reduce the manufacturing cost of our server appliance products. Our efforts to produce higher margin server appliance products, continue to improve our server appliance products and produce new server appliance products may make it difficult to reduce our manufacturing cost per product. Further, utilization of a contract manufacturer may not allow us to reduce our cost per product. If we fail to respond adequately to pricing pressures, to competitive products with improved performance or to developments with respect to the other factors on which we compete, we could lose customers or orders. If we are unable to compete effectively, our business and prospects could be seriously harmed.

Risks related to the server appliance, data storage and network security markets.

If server appliances are not increasingly adopted as a solution to meet companies' networking application needs, the market for our server appliance solutions may not grow, which could negatively impact our revenues.

We expect that a substantial portion of our revenues will come from sales of server appliance solutions and customized integration services and, eventually, the sale of server appliance solutions through our Distribution operations. As a result, we are substantially dependent on the growing use of server appliances to meet businesses' storage and security networking application needs. The market for server appliance products has only recently begun to develop and we believe it is evolving rapidly. Because this market is relatively new, we cannot predict its potential size or future growth rate with a high degree of certainty. Our revenues may not grow and the market price of our common stock could decline if the server appliance market does not grow as rapidly as we expect.

Our expectations for the growth of the server appliance market may not be